



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201227006**

Release Date: 7/6/2012

Date: April 17, 2012

UIL Code: 501.03-05

501.32-00

501.33-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

All Years

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038 (CG) (11-2005)
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: March 1, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B = President
C = Secretary/Treasurer
D = Board Member
E = Related for-profit company
F = Grant-writing company
G = Contracted company
r = year
s = date
t = date
v = date
x = date
y = state
z = amount of grant

UIL: 501.03.05

501.32.00

501.33.00

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a) as an organization described in section 501(c)(3). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

ISSUE

Are you formed to obtain grants primarily benefitting B and C through E, thus constituting inurement of earnings to insiders and precluding exemption under section 501(c)(3)? Yes, for the reasons stated below.

FACTS

B was contacted by telephone on s by F about opportunities to pursue grants for for-profit company E. B is the President and owner of E. He bought the company in r. C is the wife of B and also works for E.

F informed B and C that it would provide services geared towards securing a grant for E. The grant amount is expected to total z dollars. Currently, there is no written contract with F pending the outcome of your exemption application. However, B and C paid fees totaling more than \$2,500 to F for F to seek grant funding.

In order to secure the grant funds, B and C were told that 5% of the grant funds would have to go to a non-profit and they were directed to contract with G. You stated that G is working with F, and was hired on t to file for non-profit corporate status in order to receive grant funding. The contract with G indicates G will prepare Articles of Incorporation, assist in obtaining an EIN, prepare and assist in filing a 1023 application, provide Bylaws, minutes, corporate resolutions, etc. and provide support with any additional follow-up. The contract shows that B paid approximately \$6,000 for these services. The understanding was that when "the IRS approves non-profit status," the funds would be transferred to E.

As a result of the contract with G, you were incorporated on v in the state of y as a nonprofit corporation. You applied for exemption on x in order to secure the grant funding for E, offered by F.

Individuals B, C and D are listed as your Directors, with B as your President and C as your Secretary and Treasurer. As noted above, B and C are husband and wife. D is also related to B and C.

According to your narrative description of activities, your purpose is to help support other charitable organizations within the community. You named one specific charity that provides services for abused and neglected children to which you will provide funding. You stated that funds will also be provided to B, as president, for operating costs. Operations will be set up in a small office shared with E and funds will be limited to employees, other charitable organizations and vendors in association with you, such as rent, utilities and operating expenses. In subsequent correspondence, you stated that the president will no longer be given operating expenses, but the secretary will receive a salary.

You indicated that one of the requirements of receiving the grant for E is to spend 5% on a charitable organization and the rest within a one year period. E will use the funds to modernize its business by updating equipment, making property and building repairs, modernizing logistics equipment, and buying newer equipment. You will keep records through separate accounts set up for the grant money; one for you and one for E. You provided an itemized list of expenditures for the modernization of E, equal to 95% of the total anticipated amount of the grant.

In summary, you were formed to aid for-profit company E in securing a grant of z dollars. Of the total grant amount, 95% will go to E to modernize its business and 5% will go to you. The 5% you receive will be contributed to charitable organizations in your area.

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides an organization is not organized and operated exclusively for one or more exempt purposes unless it serves public rather than private interests. Thus, to meet the requirement it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Rev. Rul. 61-170, 1961-1 C.B. 112, an association composed of professional private duty nurses and practical nurses that supported and operated a nurses' registry primarily to afford greater opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In KJ's Fund Raisers, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998), the Tax Court found that while the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages. The initial directors were the two founders and a related individual. The initial board was replaced several times until the two founders were no longer on the board. At all times these two individuals were the organization's officers, salaries had been paid to them and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The Court took another view: "Although those practices ceased and are not in issue here, the current board of directors is composed of at least the majority of the same members who allowed those amounts to be paid."

In Church by Mail, Inc. v. Commissioner, (1985) the Court affirmed a Tax Court decision. Church by Mail sent out sermons in numerous mailings which required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. This company also employed family members. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit

company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. The employees of the company spend two-thirds of their time working on the services provided to the church. The majority of the Church's income is paid to the for-profit company to cover repayments on loan principal, interest, and commissions. The Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church." Moreover, the ministers' dual control of both the Church and the for-profit company enables them to profit from the affiliation of the two entities through increased compensation.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related non-profit organization were carried on, the latter organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

Application of Law:

You are not described in section 501(c)(3) of the Code because you are not organized and operated exclusively for charitable, educational, or religious purposes. Instead, you were formed for the purpose of obtaining grant funding that will primarily be used by E to modernize its business.

You do not meet the requirements of section 1.501(c)(3)-1(c)(2) of the regulations because your net earnings inure to the benefit of individuals. Specifically, B and C will receive substantial private benefit as a result of the grant funds received by E. The facts show that substantially all of the grant funds secured will be used to modernize the business of E by updating equipment, making property and building repairs, modernizing logistics equipment and buying newer equipment. In fact, based on the timeline of events and the contract and discussions with F and G, your primary purpose is to secure large grant funds for E, which substantially benefits B and C.

You do not meet the requirements of section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations because you have not established that you are not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. In fact you are in direct contrast of this regulation because your primary purpose is to benefit the private interests of B and C by securing grant funding for E. Since B and C are also principles of you, this constitutes inurement.

You are similar to the organization described in Revenue Ruling 61-170. Your mission to obtain and expend grant monies to substantially improve for-profit company E primarily benefits B and C and not the public at large.

Although you will conduct the charitable activity of providing funds to charitable organizations that are exempt under section 501(c)(3) of the Code, you also have a substantial non-exempt purpose

of securing grant funds for E. As explained in Better Business Bureau of Washington D.C., Inc. V. United States, the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption.

Similar to the organization in KJ's Fund Raisers, private rather than public interests are being served. The same individuals that will have control over your operations will also be simultaneously controlling E. You are structured to allow for the flow of funds to E. The decision to use E's facility and your limited board, demonstrates a lack of public oversight and control as well as serving the private interests of B and C.

Similar to the organization in Church by Mail, common control exists between your board and E that enables those owners of E, your founders, to benefit from this relationship. Through your activities of obtaining grant funding and passing substantially all of it to E, B and C will benefit.

Like the organization in International Postgraduate Medical Foundation, E benefits substantially from your operation in the form of the receipt of grant funding to expand and supplement its business purposes. Because you are formed to further private interests through your operations you do not qualify for exemption under Section 501(c)(3).

Applicant's Position

You have provided no further information since our discussion of the facts stated above.

Conclusion:

In summary, you do not meet the requirements under section 501(c)(3) because your net earnings inure to the benefit of individuals B and C. Your entire reason for forming was to obtain grant monies, and in turn, use these funds for the benefit of B and C through their for-profit company E. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892; *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;

4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure: Publication 892